Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
A La Carte and Themed Programming	)	MB Docket No. 04-207
and Pricing Options for Programming	)	
Distribution on Cable Television and	)	
Direct Broadcast Satellite Systems	)	

COMMENTS OF
<u>THE NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION</u>

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The National Cable & Telecommunications Association ("NCTA") hereby submits its comments on the Commission's Public Notice in the above-captioned proceeding. At the request of several members of Congress, the Commission is preparing a report on the provision of programming by multichannel video programming distributors ("MVPDs"), such as cable operators and direct broadcast satellite ("DBS") on an à la carte or "themed tier" basis.

NCTA is the principal trade association of the cable television industry. NCTA's members include the operators of cable television systems serving more than 90% of the nation's cable television subscribers. NCTA also includes operators of more than 200 cable program networks, as well as companies that provide equipment and services to the industry.

INTRODUCTION

The prospect of government-mandated controls over cable programming through à la carte or tiering requirements on operators raises the most serious policy, economic, and legal concerns. It injects the government into myriad, and intricate, pricing arrangements among hundreds of program suppliers and thousands of operators who distribute the programming. It casts the blanket of government regulation over a medium of communication, saying which networks can be sold one way versus another, through a "themed tier" or other method of network discrimination. It erects a high hurdle for new programmers, especially those with narrow and diverse focus, who are being told by government that their distributors cannot sell their programming in the way they and the operator would choose to. And it portends new rounds of rate regulation, if "voluntary" tiering and à la carte pricing doesn't deliver exactly the result its proponents seek.

If we have learned anything from the past errors of communications policy, particularly as concerns the cable industry, it is that government micromanagement of the market is a bad idea that spawns a worse result than the alleged problem it addresses. It is a lever to be pulled only in the most extreme and clear-cut cases. That is not this case.

The superficial appeal of the premise of à la carte pricing – who among us does not prefer to pay for just what we watch? – ignores the overwhelming appeal of the current mix of tiers and à la carte on cable and satellite, as evidenced by the near saturation of available television households for these products. There is no market failure here. Rather, this is a video marketplace that leads the world in programming diversity.

It is one thing for a cable operator and programmer to decide as a marketplace matter that a channel should be offered à la carte or on a mini-tier. Many channels are offered this way today. It is quite another for the government to assign itself the task of making these marketing decisions.

Worse, if one looks at models of the likeliest à la carte and tiering scenarios – as the attached in-depth study by Booz Allen Hamilton does – the supposed savings for a very few are quickly washed out by increased prices for most consumers. This downward price/value spiral would be compounded by a likely quality deterioration of the surviving programming networks.

Moreover, these scenarios all involve pulling up the ladder from diverse new programmers at a time when they are seeking to meet unfulfilled market needs.

Not only do government-mandated tiering and à la carte make bad policy and economic sense; they raise fundamental concerns about constitutional rights. For over 20 years, the U.S. Supreme Court has repeatedly recognized that cable operators enjoy First Amendment protection when they select and package programming. For at least as long, customers have been able to block undesirable channels from their homes, and the cable industry this year has voluntarily expanded its efforts to ensure that every customer can determine which programming is appropriate for its household.

Government intrusion into an operator's editorial selections should only occur for the most compelling and clearly articulated reasons. As these comments will demonstrate, the superficially appealing reasoning behind à la carte is unsupportable as a matter of economics. And concerns regarding content of certain tiered program networks are amply addressed by blocking technologies, a solution far less drastic and restrictive than mandated à la carte or themed tiering.

Finally, it should be remembered that government control of the competitive cable and satellite distribution market – for that is what mandatory tiering or à la carte is – would have profound implications going beyond just television. With over 300 networks, the cable industry has not only spawned the world's greatest television programming diversity. It has, through private investment, created and implemented an overlay system of residential broadband. And it is now is poised to be the first major facilities-based competitor to the incumbent phone system. This industry has helped the country grow through job creation and the productivity generated by broadband both in commerce and education.

Government should resist the temptation to inject itself into cable economics to address the issues raised by tiering and bundling, especially when the overwhelming evidence indicates that such involvement would make consumers generally worse off. And it should recognize that the serious harms and uncertainty that would be visited on the traditional cable programming business would inevitably affect the ability of cable to deliver on its other services to the American people.

SUMMARY

With respect to à la carte availability, the question is not whether *some* particular services could be offered as per-channel options. Some program networks already are – and always have been – offered to cable customers on a per-channel basis. In particular, some movie channels have from their inception been marketed as commercial-free "premium" channels at an extra charge. Some sports channels, foreign language channels and other special interest services also are, or have been, offered on an à la carte basis.

Optional tiers have also been offered by cable systems and, in fact, are becoming more prevalent with the advent of digitally delivered programming. Offering *analog* programming on an à la carte basis or in multiple optional packages requires either the installation of multiple "traps" at customers' homes – a costly and technologically problematic approach – or the encryption or "scrambling" of all such programming and the placement of set-top unscrambling devices in all analog customers' homes. But many cable operators now offer multiple packages of *digital* programming, in addition to premium movie channels, pay-per-view movies and events, packages of professional baseball, basketball and hockey games and college football games, and video-on-demand movies – all of which are available on an optional basis.

In fact, the *only* programming that is not optional is the basic broadcast tier that includes local broadcast stations and public, educational and government access channels. Congress has provided that cable operators (unlike DBS providers) must provide this tier to *all* cable customers[1] – even though many might otherwise choose to avoid the cost of this tier (which averages almost $15 per month)[2] and rely on an over-the-air antenna to receive local broadcast stations.

Cable customers are not required to purchase the "expanded basic" tier of programming in order to purchase additional premium channels or pay-per-view events. But most subscribers do buy that tier because it typically includes not only many channels that they highly value and regularly watch but also a large number of channels that they can sample and watch occasionally.

The ability to explore and sample a wide range of programming in addition to each subscriber's favorites has hardly detracted from the attractiveness of cable service to consumers. Consumption of cable programming, as measured by viewing hours spent watching cable networks, steadily increased as cable operators increased their channel capacity and added new channels to expanded basic tiers. And newly added networks are responsible for at least as much of that increase as older established networks.[3] In other words, the ability to sample and try out programming networks has enhanced the value and attractiveness of cable to consumers.

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1 *See* 47 U.S.C. § 543(b)(7)(A). *See also* 47 U.S.C. § 534(b)(7).

2 Report on Cable Industry Prices, 18 FCC Rcd 13284, 13286 (2003).

3 Booz Allen Hamilton, "The a la Carte Paradox: Higher Consumer Costs and Reduced Programming Diversity" (July 2004)("Booz Allen"), attached to these comments as Attachment A, at 15.

Nevertheless, most subscribers do not watch, or even sample, *every* program network that is available to them. And sometimes some might wonder why they cannot purchase *only* those channels that they would like to purchase instead of having to buy the entire tier.

The question assumes that, under an à la carte approach, the same array of services would be available to consumers, and that the price of purchasing only a fraction of the services on the tier would be a corresponding fraction of what the tier currently costs. Unfortunately, as NCTA and others have argued before, as the General Accounting Office has recently recognized,[4] and as these comments will demonstrate anew, this would not be the case. Requiring *all* services to be offered on an à la carte basis – even if they could also be packaged and offered in tiers – would add substantial costs to the production, provision and price of such services. And, in many cases, it would undermine the quality, diversity and economic viability of the cable networks available to customers.

Part of the problem is technological. If services are to be available only to those customers who choose to purchase them, cable operators must have a cost-effective way to block their availability to those customers who choose *not* to purchase them. For services that are transmitted to customers' homes in analog format, the only practical way to block their availability is physically to install "traps" at customers' homes.

Almost all customers' analog television sets today are "cable ready" and can tune to and receive analog cable channels without a set-top box, as long as the signals delivered on such channels are not "scrambled" or encrypted by the cable operator. Traps physically prevent an

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[4] *See* General Accounting Office, "Issues Related to Competition and Subscriber Rates in the Cable Television Industry," Report to the Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate (October 2003) ("GAO Report"). *See also* Bear Stearns, "À La Smart?," March 29, 2004, p.3 ("Our numbers, however, imply that there may be little money saved by any household opting for 10-15 channels, especially if they are the more popular ones.")

unscrambled channel – or a group of adjacent channels – from reaching the sets of customers who do not purchase such channels. But because the channels are only trapped at those customers' homes, other customers who do choose to purchase the channels can view them without a set-top box on their cable-ready sets.

But cable systems can physically accommodate only a limited number of traps. Accordingly, cable operators can use traps to block access to a tier or two of adjacent channels, and/or one or two premium channels. But traps are not a feasible way of blocking access to multiple channels that are not packaged and offered in a single group of adjacent channels.

There is only one practical way to allow customers to choose whether or not to purchase particular non-adjacent channels instead of offering such services only in a package or tier. To make such channels available on an à la carte basis, cable operators would have to deliver them in *digital* format, require all customers to purchase or lease addressable digital set-top boxes, and electronically ensure that a customer's set-top box unscrambles only those channels that the customer has purchased.

Transmitting all channels digitally and requiring all customers to purchase digital set-top boxes would impose significant costs, disruption and consumer inconvenience. Today, only 30% of all cable customers subscribe to the digital tiers and services offered by cable operators, and not all televisions in digital cable homes currently are equipped with digital set-top boxes.[5] Even if a large portion of customers would prefer to continue to receive *all* the program services currently available on analog tiers, the only way to enable those customers to do so without a digital set-top box would be to transmit such services in both analog *and* digital format. In most instances, this would be an especially costly and wasteful use of the expanded channel capacity

5 Kagan World Media, Broadband Cable Financial Databook, 2003 at 11.

that operators recently deployed, at a cost of tens of billions of dollars, in order to provide the broadest and most desirable array of services to consumers.

But the problems with an à la carte requirement are not merely technological. Requiring that customers be given the option of purchasing some but not all of the diverse array of program networks currently available only on a tiered basis would fundamentally undermine the economic model that has enabled cable operators to offer those networks.

Cable networks rely on two primary sources of revenue – advertising and license fees from cable operators and other distributors. As GAO has recognized, the advertising revenues of networks currently offered on large "expanded basic" tiers by cable systems are generally based on the total number of subscribers to such tiers, "since the amount that companies are willing to pay for advertising spots is based on the number of *potential* viewers."[6] If only a portion of current tier subscribers purchase a particular network, the network's advertising revenues will be reduced. At the same time, because of the need to persuade customers to purchase their service on an à la carte basis, the network's marketing and promotional expenses will sharply increase.

To recover the same amount of total revenue, the network will have to increase its license fee, which will, in turn, increase the cost of programming to cable and DBS subscribers. Moreover, not only will the license fee be higher; it will have to be recovered from a smaller number of subscribers, further increasing the cost of the network to those who choose to purchase it.

[6] GAO Report at 6 (emphasis added).

But increasing the per-subscriber cost of a service will, in turn, further reduce the number of subscribers. Whether this vicious circle will lead to an equilibrium price at which there are a sufficient number of buyers to continue to sustain the network or will instead become a downward spiral that destroys the network's viability will depend on the nature of the demand for each particular network. It may be that the network will have no choice but to respond to lower advertising revenue and fewer subscribers by reducing the cost – and quality – of its programming. But this reduction in quality is only likely to further diminish the attractiveness of the network and further reduce the number of customers who choose to purchase the network. The spiral downward continues.

For all these reasons, the notion that some form of à la carte requirement could provide consumers with the opportunity to pick and choose from among all the same networks currently available to them on basic and expanded basic tiers, with a proportionate reduction in the price that they pay and no reduction in the quality of the programming, is illusory. Unless virtually all subscribers continued to purchase virtually all the networks offered on the tiers, an à la carte requirement would raise the per-channel prices of such networks. And/or it would reduce the quality of the programming on such networks. And/or it would reduce the number and diversity of viable networks available to purchase and view.

This does not necessarily mean that *all* consumers would be made worse off under an à la carte regime. Some consumers – especially those who only care to watch a handful of the most popular networks, and rarely if ever watch any other networks – might conceivably end up paying less under an à la carte approach (although many of these viewers are likely to experience a decline in the quality of the networks that they watch). As GAO has pointed out, "[a] variety of factors – such as the pricing of à la carte service, consumers' purchasing patterns, and whether certain niche networks would cease to exist with à la carte service – make it difficult to ascertain how many consumers would be better off and how many would be worse off under an à la carte approach."[7]

As the GAO Report makes clear, cable operators and program networks are convinced that mandating that networks be offered on an à la carte basis rather than allowing the marketplace to determine how particular networks should be packaged and offered to consumers will make most cable customers considerably worse off and will fundamentally undermine the economics of their businesses. To provide an independent, empirically grounded analysis of the extent to which this is true, NCTA retained the management consulting firm Booz Allen Hamilton to assess with greater specificity the likely effects of several à la carte approaches.

Booz Allen & Hamilton is the leading international management and technology consulting firm committed to helping senior management solve complex problems. The global Media and Entertainment practice at Booz Allen has worked alongside the senior management of many of the leading media and entertainment companies to design strategies and help implement change.

Specifically, Booz Allen Hamilton examined three prototypical scenarios: (1) a "pure" à la carte approach under which all networks currently available on basic and expanded basic tiers were available *only* on a per-channel, à la carte basis; (2) an "optional" à la carte approach, under which networks could continue to be packaged and offered on their current tiered basis but would *also* be available on an à la carte basis to those customers who wanted to purchase fewer than all tiered networks; and (3) a "themed tier" approach under which cable operators were

7 *Id.*

required to offer one or more smaller packages of programming based on content, in addition to the more inclusive currently available basic and expanded basic tiers.

As discussed in more detail in Section II of these comments, and in comprehensive detail by Booz Allen in the attached report, Booz Allen confirmed that "[u]nder each of the scenarios evaluated, *consumers* would be worse off than today. Consumers would either pay more than today for far fewer channels, or would need to select as few as six channels to reduce their monthly bill below current levels."[8] For most consumers, therefore, purchasing services on an à la carte or "themed tier" basis would not make sense. But the Booz Allen study shows that because of the costs associated with offering an à la carte or themed tier option, even those cable customers who chose to continue to purchase the existing tiers would have to pay significantly more than they do today.

Moreover, Booz Allen projects that the number, quality and diversity of program networks would all be severely diminished under an à la carte regime. Booz Allen concludes that "[a]s many as half to three-quarters of emerging networks could fail under each of the scenarios, including a growing number of targeted niche and ethnic programming networks, and new network launches would become extremely unlikely."[9] Furthermore, "even the most established networks would likely have to reduce their expenditures on programming, leading to lower viewing and lost advertising."[10] In the end, this would not only diminish the number of available program networks but also "would likely lead to further industry consolidation into fewer network groups."[11]

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[8] Booz Allen at 1.

[9] *Id.* at 2.

[10] *Id.*

[11] *Id*.

Some observers have suggested that cable systems are offering services on an à la carte and themed tier basis in Canada in a manner that could readily be adopted in the United States to the benefit of consumers. That is hardly the case. First of all, the Canadian experience confirms the basic point that à la carte services and themed tiers can only be offered if they are provided *digitally* by cable systems. The only services being offered on such a basis by most Canadian cable systems are services on digital tiers. The large array of widely viewed services are available on analog tiers and on analog tiers only.

Some systems in French-speaking Quebec, where those popular English language services are not predominant, do offer those tiered analog services on an à la carte basis. But they have done so by duplicating the services digitally, so that all à la carte customers must pay for and use digital set-top boxes. The Booz Allen report shows how costly that approach would be for cable customers in the United States.[12]

Moreover, the cable programming marketplace in Canada hardly resembles the competitive marketplace faced by program networks in the United States. As described by Michael Hennessy, President of the Canadian Cable Television Association, in a recent speech attached to these comments,[13] Canadian law and regulation is designed not to promote choice and competition among program networks but to promote Canadian cable services and protect them from competition.

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12 *Id.* at 5.

13 Remarks by Michael Hennessy, President and CEO, Canadian Cable Television Association, to Washington Metropolitan Cable Club, June 29, 2004 (Attachment C).

Like broadcast stations in the United States, many Canadian cable networks are licensed and guaranteed carriage on analog tiers. Services that offer similar program formats, which would compete with those protected networks, are not licensed by the government at all. Services licensed since 2000 – including United States networks – are only available on scarcely viewed digital tiers. And à la carte distribution may, in these circumstances, be better for these digital networks than no distribution at all.

As Mr. Hennessy has pointed out, the Canadian model is hardly an example of a marketplace that is working to promote consumer access to desirable programming at affordable prices. In his view, cable customers in the United States have far more choice and diversity than their Canadian counterparts, and "it seems quite odd that U.S. regulators would look at à la carte, this none-too-successful aspect of the Canadian system, as a way to improve your admirable system."[14]

In the face of the GAO Report and the Booz Allen study, it is hard to imagine that lawmakers would choose to intervene in the marketplace to impose or encourage a marketing approach that would make virtually all cable customers worse off. But even if they wanted to do so, the impact of such an intervention on the First Amendment rights of operators and program networks would render such a step unconstitutional.

NCTA asked noted constitutional law experts Geoffrey Stone and David Strauss, Professors of Law at the University of Chicago, to analyze the First Amendment implications of requiring cable operators and program networks to make their programming available on an à la carte or themed tier basis. Their analysis is attached to these comments and is discussed in more

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14 *Id.* at 7.

detail in Section IV. But their straightforward and unequivocal conclusion can be briefly stated here: "In our judgment and against this background, both the à la carte and themed-tier requirements would violate the First Amendment."[15]

As Professors Stone and Strauss explain, the Supreme Court has repeatedly held that cable operators, when they select and offer programming to their customers, are protected by the First Amendment's "freedom of the press." Any law or regulation that singles out and imposes a significant burden on a protected medium of communications must meet a heightened standard of justification under the First Amendment. An à la carte requirement would single out and directly restrict the editorial discretion of cable operators.

Such a restriction, if applied to newspapers, would be unthinkable – and Professors Stone and Strauss conclude that, under the standards set forth in the Supreme Court's *Turner Broadcasting* decisions, it would fare no better if applied to cable. There is no government interest of sufficient importance to justify the substantial burdens of an à la carte requirement. And even if the government *did* have a substantial and important interest in enabling cable customers to lower their bills and keep out unwanted programming by purchasing only those program networks that they wanted, an à la carte requirement would still fail the test.

As the GAO Report suggested and the Booz Allen study confirms, an à la carte requirement would *not* enable consumers to watch only what they want at lower prices. It would give consumers the "option" of paying *more* than they pay today to purchase fewer networks than they watch regularly today. And even if consumers were willing to pay more than they pay today in order to keep certain unwanted programming from reaching their homes, there is

[15] Geoffrey R. Stone & David A. Strauss, "The First Amendment Implications of Government-Imposed À La Carte and Themed-Tier Requirements on Cable Operators and Program Networks" (2002) ("Stone & Strauss") attached to these comments as Attachment B) at 3.

already a way to achieve this result with less intrusion on editorial discretion and protected speech: Consumers, whose sets may already include blocking options and V-chips, may also obtain free blocking technology from their cable operators to prevent the viewing of unwanted programming on any and all channels.

In these circumstances, Professors Stone and Strauss conclude that à la carte and themed tier requirements would fail to survive even the "intermediate" scrutiny established in *Turner* for "content-neutral" regulations. Moreover, they conclude that it is unlikely that a themed tier requirement that singled out or was intended to promote (or hinder) a particular type of programming based on its *content* could be sustained in *any* circumstances.

I. THE MARKETPLACE HAS HISTORICALLY DETERMINED WHETHER CABLE AND SATELLITE PROGRAMMING IS OFFERED IN TIERS OR ON A PER-CHANNEL BASIS.

Almost since the advent of cable television, cable operators have offered some programming to subscribers in tiers and other programming on a per-channel (and, in some case, a per-program) basis. To a very limited extent, this is the result or legacy of regulatory requirements. But for the most part, the manner in which particular programming is packaged and offered has evolved along with, and in response to, cable technology and the marketplace in which operators and programmers compete.

At the outset, more than half a century ago, cable television was simply a technology for retransmitting local and distant broadcast stations to areas unserved or underserved by over-the-air signals. Systems generally were equipped to provide no more than 12 channels of programming, which were transmitted by coaxial cable on the same 12 VHF frequencies used by over-the-air broadcasters. Subscribers simply attached the cable to their sets in lieu of an over-the-air antenna and tuned to the 12 channels on their television sets to receive all the signals being delivered by the cable system.

Even during those days, before the advent of satellite-delivered cable programming, cable operators began offering movie and sports programming on an optional à la carte, per-channel basis. These "premium" channels were, like the retransmitted broadcast channels, provided on one of the 12 VHF frequencies. But they were blocked by physical "traps" from reaching the homes of customers who chose not to purchase them.

At that time, the FCC actually *discouraged* the offering of these à la carte channels. The Commission was concerned that premium movie and sports programming would lure viewers (and advertising revenues) away from over-the-air broadcast stations, and, in 1970, it adopted "anti-siphoning" rules to prevent this from occurring. Those rules prohibited cable operators from showing on premium channels (1) any movies that had been in theatrical release less than two years prior to being cablecast; (2) any sports events that had been televised live on broadcast channels in the cable community during the previous two years; and (3) any "series" programming. And they prohibited premium cable channels from carrying advertising.

Seven years later, the United States Court of Appeals for the District of Columbia Circuit held that the anti-siphoning rules violated the First Amendment rights of cable operators.[16] That decision, along with the advent of satellite technology for the nationwide delivery of programming to cable systems, transformed the array of programming available to cable subscribers. Premium channels like HBO and Showtime began providing recent movies, uncut and commercial-free. But satellite delivery and the right to include advertising in nonbroadcast

[16] *See Home Box Office v. FCC*, 567 F.2d 9 (D.C. Cir.), *cert. denied*, 434 U.S. 829 (1977).

cable programming also spawned the development of a multitude of cable program networks with all sorts of diverse formats and content. Except for a brief period in the mid-1990's when cable rates were subject to severely constraining regulation, the number, diversity, quality – and viewership – of cable networks have steadily grown ever since.

To accommodate all these new services, cable operators upgraded the channel capacity of their systems. In addition to using the 12 VHF frequencies of the 1970's era TV sets, operators transmitted additional channels in additional blocks of frequencies not used by over-the-air television, and not initially receivable by the television sets then in use by consumers. To receive the additional channels, customers needed a set-top converter box, which would convert whatever channel the customer selected, so that it could be received and viewed on VHF channel 3 or 4 of the customer's television set.

While one or two premium channels could continue to be provided on an à la carte basis using traps, it is not technologically feasible to offer a large array of new satellite-delivered networks in that manner. Instead, most of the new networks were bundled into a tier – either along with the broadcast signals on the "basic" tier, or in an additionally available "expanded basic" tier. A single trap can be used to provide selective access to any number of adjacent channels placed in a single tier, but providing à la carte access to a large number of channels would require more traps than can be technically accommodated at each subscriber home.

Nor was it economically feasible to offer all the new networks on an à la carte basis. Most of those networks had little or no stand-alone brand name recognition. Unlike the case of premium movie channels, most could not count on recouping their programming costs from the portion of cable subscribers willing to pay separately for their services. Indeed, most could not count on recouping their costs from affiliate fees alone, even if the service were included in a tier and sold to *all* subscribers. Instead, their business plans usually depended on significant revenues from *advertising* – which, in turn, depended on their programming being available for at least occasional viewing by as many subscribers as possible.

The need for broadly collected license fees and the widest distribution possible made the packaging of most networks together in a tier essential to programmers. This approach also was optimal for cable operators and their subscribers. By offering a diverse group of program networks in a single package, operators were able to induce the largest number of subscribers to purchase cable service while maximizing the viability of those program networks. For consumers, the whole was greater than the sum of the parts. Customers who did not need cable for off-air reception found in the growing tiers a reason to subscribe.

Just as different subscribers to a daily newspaper value different sections, syndicated columns and features differently, subscribers to tiers of cable program networks all have program networks they favor over others. Bundling all these services together led to significant cost reductions and greater efficiencies in distribution. It invited sampling of new networks and experimentation with programming ideas, creating increased consumer welfare amid an increasingly diverse program mix. And this, in turn, bolstered the health and viability of all services, enhancing the likelihood that everybody's favorites would survive – and also ensuring that everybody would have the opportunity to sample and find new favorites, and new candidates for occasional viewing.

While most of the cable program networks added to cable systems during this period of expansion were included in the basic or expanded basic tier, a number of new networks were launched as à la carte, premium channels. Some of these, like the earlier established premium channels, primarily showed uncut, recently released movies. Others offered regional sports programming. Still others sought to carve out their own niche format.

For example, the Entertainment Channel, launched in 1982, focused on telecasting stage productions of Broadway shows.[17] The original Bravo network, launched in 1980, provided feature films with more of an "art film" or foreign film flavor than the established movie channels.[18] American Movie Classics offered uncut and uninterrupted films from earlier decades. Encore provided movies older than those provided by the first-run movie channels but newer than the classic films on AMC. The Disney Channel, launched in 1983, provided family and children's movies and other programming.[19] In 1979, Galavision was launched as a pay service, offering Spanish-language films and other programming.[20] More recently, in 1995, the Golf Channel was launched as a premium channel.

Most of these premium channels carried no commercials and were offered to consumers for approximately ten dollars per month, although the channels offering older vintage movies and features cost less. Encore, for example, was initially offered as an à la carte option for approximately one dollar per month.

Many of the premium channels are still operating today. For these networks, the number of consumers willing to pay a premium price in order to view recent movies and other programming without commercial interruption must be sufficient to cover the programmers' and operators' costs of acquiring, producing and providing such programming. Other services originally provided on an à la carte basis found, however, that their formats were better suited to

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[17] *See* G. Kent Webb, *The Economics of Cable Television* at 12 (1983).

[18] *Id.*

[19] *Id.*

[20] *Id.*

being offered on basic and enhanced basic tiers. For example, Bravo, American Movie Classics, Disney Channel, Galavision, Golf Channel and many regional sports networks are now provided on such tiers. Similarly, the Entertainment Channel merged with ARTS, a basic-tier network, to become Arts & Entertainment (A&E). Most of those channels now carry advertising.[21]

The addition of these former premium channels to basic and enhanced basic tiers added costs to such tiers and, in effect, required all tier subscribers to share such costs whether or not they watched the programming. But this hardly means it was a bad thing for subscribers. For example, when New England Sports Network (NESN) was offered as a premium service, subscribers had to pay an extra $8 to $10 to receive it. When it became a basic tiered service in 2001, it "add[ed] between $1 and $1.50 to the average cable customer's bill."[22]

This may not have benefited viewers who *never* watch sports programming or who valued the channel at less than the additional dollar per month. But it was good news for subscribers who valued the channel at more than $1 – especially those subscribers who were unwilling or unable to pay $8 to $10 but were now able to watch Boston Red Sox games. And, as Rep. Ed Markey (D-MA), the consumer-oriented Ranking Minority Member of the House Telecommunications and Internet Subcommittee who praised the switch to the basic tier observed, there were substantially more of the latter than the former: "[H]ere's one thing that a high percentage of people are going to want."[23] Whether or not migration of sports from à la

21 NCTA, *Cable Developments 2004*, "Cable Programming Services" (2004).

22 "Sox TV Package Driving Up Cable Rates," Boston Globe, Jan. 19, 2001, p. A1.

23 *Id.*

carte to basic makes sense in every circumstance, what is important is that these decisions be left to the market, as varying models will apply for particular networks in different communities.

In the 1990s, cable operators nationwide embarked on major rebuilds of their systems in order to meet the competitive challenges of the digital era. The result has been a substantially increased number of program services and enhancements for cable customers. And, while some new channels have been added to existing analog tiers, most of the new services are available as additional *options*. For example, customers may choose to purchase one or more new digital tiers of programming, including high-definition programming. They can select from a wide array of pay-per-view and video-on-demand programming. And they can add personal video recording capability.

All these developments have been driven by marketplace forces, based on fierce competition from DBS and by characteristics of supply and demand. Thus, the marketplace continues to determine whether new services will be offered as à la carte premium services, as digital tiered services, or as additional or replacement services on existing analog tiers. And the addition of these new services has clearly continued to enhance the value of cable service to consumers.

This is evident from the fact that viewing of cable programming has increased dramatically in recent years – *and at least as much of that increase is attributable to viewing of newer networks as to viewing of established networks*. Between 1998 and 2003, daily viewing hours of cable programming per household grew by almost 30%, from 3.7 to 4.8 hours. Of that increase, 0.5 hours were attributable to established networks and 0.6 hours were attributable to newer networks.[24]

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[24] Booz Allen at 15.

So, it's not the case that, as some of cable's critics have suggested, consumers don't want any more new channels and don't value the new channels that have been added in recent years. To the contrary, as cable operators add new channels and services, cable service becomes more and more attractive to consumers. This is exactly the outcome that a competitive marketplace can be counted upon to produce.

Nevertheless, some have suggested that consumers might be made better off yet if consumers were given the opportunity to purchase some or all of the services currently offered only on the basic or enhanced basic tiers on an à la carte basis, or in smaller, "themed" tiers. To the extent that the combination of tiers, mini-tiers and per-channel premium services that have developed over the years represent the marketplace at work, one would expect that any such à la carte approaches would only diminish consumer welfare. And last year, as discussed above, GAO explained the reasons why consumers would likely be worse off under an à la carte regime.

Are the assumptions underlying that conclusion valid? Is the marketplace serving consumers better than an artificially induced à la carte approach? As noted above, in order to understand more fully how à la carte (or themed tier) availability of tiered services would affect consumers, NCTA retained Booz Allen Hamilton to model and project the likely outcome, based on its best assessment of how cable operators, program networks and consumers would respond. In the next section, we describe what Booz Allen Hamilton found.

II. THE RESULTS OF AN ARTIFICIALLY INDUCED À LA CARTE REGIME: HIGHER PRICES, LESS CHOICE, LESS DIVERSITY AND LOWER QUALITY.

Based on its long-term experience in the media and entertainment industry, on interviews with cable operators and cable program network executives (large and small, vertically integrated and non-integrated), on interviews with executives at major TV advertising buying groups, and on empirical industry data, Booz Allen developed a detailed economic model to assess the impact of several artificially induced à la carte scenarios on operators, program networks and, ultimately, consumers.

Booz Allen examined three scenarios:

1. A pure à la carte regime, in which all programming (except broadcast channels, which are currently required by law to be packaged and provided to all consumers on a basic tier) is available *only* on an à la carte basis and cannot be purchased as part of a tier;

2. An optional à la carte regime, in which all currently tiered programming (except broadcast channels) is available on an à la carte basis, but consumers can continue to opt to purchase the currently available tiers; and

3. A specific themed tier approach, in which consumers may purchase a smaller content-based tier of services, which are also available on currently available tiers.

In each of the scenarios, the model shows that the average consumer – indeed, almost all consumers – would be significantly worse off.[25] Consumers would pay significantly more to receive only those program networks that they currently watch regularly (or to watch a themed tier) than they now pay to receive *all* the channels on their basic and enhanced basic tiers. And even if they still had the option of purchasing the currently existing tiers instead of opting for à la carte, the prices of those tiers would be significantly higher than they are today.

The details and methodology of Booz Allen's analysis are set forth in detail in its attached paper. Booz Allen recognized the multiplicity of interrelated factors that affect the pricing, quality and availability of cable programming, but it was able to isolate and identify those variables that could be expected to have meaningful and significant effects on the outcome of the à la carte scenarios.

[25] *Id*. at 1.

A. Effects on Cable Program Networks.

The starting point is that under an à la carte regime, subscribers who pick and choose services are likely to choose to pay for a much smaller number of services than are currently available to them on existing tiers. Research suggests that the average household regularly *watches 17 channels on average among the total they receive* (including broadcast networks).[26] This leads to an important fact about cable viewing: *Only 20-30% of current subscribers account for up to 60-80% of total viewing for most cable networks*.[27] Absent major program network expenditures on branding and promotion, which do not currently occur, Booz Allen concludes that subscribers are unlikely to choose to purchase particular networks that they do not currently watch regularly.

The resulting decline in the number of subscribers who will be *able to receive* particular program networks will directly affect the advertising revenues received by those networks. As Booz Allen points out, advertising revenues are a function of viewership. Current viewership of cable networks includes not only those who are regular, heavy viewers but also occasional viewers – some of whom, upon sampling the programming, may become regular viewers themselves. If only regular viewers are likely to purchase program networks on an à la carte basis, viewership – and advertising revenues – will decline.

The extent to which advertising revenues will diminish depends, of course, on the extent to which viewership is reduced. The expected impact is greatest in the first scenario, in which programming is available only on an à la carte basis. Based on assumptions that only regular viewers of a network are likely to purchase that network on an à la carte basis and that not even

[26] Booz Allen at 6.

[27] *Id*. at 5.

all of those viewers will choose to pay the à la carte price for the network, Booz Allen projects that overall viewership will decline under the first scenario by 23%. But there is a wide variation among different types of programming. While viewership of general entertainment and sports programming is projected to decline by 18%, there would be viewership losses of 45% for emerging niche networks, and 56% for emerging mass networks.[28]

The declines in viewership under the second and third scenarios, under which cable operators could continue to offer currently existing tiers *in addition to* offering channels on an à la carte basis or offering a themed tier, would be smaller – but still substantial. A recent study conducted by Concerned Women for America and Citizens for Community Values found that 66% of those surveyed would prefer to purchase services on an à la carte or themed tier basis rather than purchase the entire tiers offered by their cable providers. Booz Allen more conservatively estimated the loss of viewership and other costs associated with à la carte if only 50% of cable customers were to opt for à la carte.

Under this assumption, cable viewing would decline overall by an estimated 13%. Emerging mass networks would suffer a decline of 29%, and emerging niche networks would be expected to lose 24%. These viewership declines would, according to Booz Allen, directly result in lost advertising revenues of from 20% to 60%.[29] Not only would advertisers pay proportionately less to reach fewer viewers. But also, as ratings fall below a critical mass and

[28] *Id.* at 26.

[29] *Id.*

cable becomes a less efficient buy for advertisers vis-à-vis other media, they will pay significantly less *per viewer.*

Along with a decline in advertising revenues, cable networks will also face increased marketing costs. In an all-or-nothing environment, in which only customers who choose to purchase a particular network will contribute *any* viewership to that network, networks will have to spend much more than they currently do on promotion and branding. Most tiered networks currently spend only 2-6% of total net revenues on marketing. Booz Allen estimates that these expenditures would increase to as much as 20% to 30% of revenues in an à la carte environment, based on benchmarks of premium cable networks and consumer packaged goods companies.[30]

The combination of diminished advertising revenues and increased marketing expenditures will put pressure on networks to increase revenues (by increasing their wholesale rates to cable and DBS operators) or cut their costs (by reducing expenditures on programming). Each approach is potentially counterproductive. Increasing prices to cable and DBS operators will further increase retail prices to customers. Those prices will already necessarily be higher, since the amount paid by operators per network will be passed through to a smaller number of customers. Depending on the elasticity of their demand for a particular network's programming, even heavy, regular viewers may not be willing to pay the higher fees necessary to cover the loss in advertiser revenues *and* the loss in subscribers.

But cutting programming expenditures is also problematic. A decline in the quality of programming will likely diminish viewership and ratings critical to advertising revenues. And it may further reduce the number of à la carte subscribers. These conundrums highlight the fact

[30] *Id.* at 28.

that, as Booz Allen subsequently shows, for some program networks, there may be no viable path to recovery from the adverse effects of an à la carte regime.

B. Effects on Cable Operators.

Cable operators will also face increased costs under an à la carte approach. One set of costs is associated with the requirement that programming purchased on an à la carte basis be transmitted on digital channels. This will, first of all, require that a digital set-top box be deployed on any television sets used by à la carte customers. Today, only about 30% of cable households subscribe to digital services. Even in these households, only 1.7 of the average three sets per household are equipped with digital set-top boxes. All television sets in à la carte homes will have to have set-top boxes so that customers receive only those channels for which they are paying subscribers.

In addition, under those scenarios in which customers may continue to purchase existing analog tiers instead of buying particular services on an à la carte basis or in a themed tier, operators will have to install traps outside the homes of all à la carte customers. This would be necessary to prevent them from receiving the entire analog tier, *i.e.*, from "trapping out" the full tier of service. And the truck rolls that it would necessitate would add significant costs.

Moreover, because an à la carte approach requires the duplication of analog channels of programming on a system's digital channels, cable operators would have to forgo other preferable uses of the spectrum. Any lost revenue that would have otherwise been generated from this spectrum represents an opportunity cost to operators. Those higher uses would presumably have generated greater revenues or customer goodwill. Furthermore, because cable viewing would be expected to decrease under à la carte scenarios, the value of local advertising sold by cable operators would diminish.

Meanwhile, customer care costs would increase substantially. The greater complexity of an à la carte system would increase the number and duration of calls to the cable operator – to learn about available options, to order à la carte services, and to change the selection of services ordered. Booz Allen estimates that this increased volume of calls would, on average, add to operators' costs by more than $2 per subscriber per month.[31] And billing costs would also go up because of the complexity of à la carte options.

C. Effects on Consumers' Prices.

All the foregoing effects of an artificial à la carte regime on cable program networks and cable operators will, in turn, directly – and adversely – affect the price, quality and availability of cable programming to consumers. Booz Allen has spelled out and quantified each of these likely effects.

As noted above, program networks are likely to seek to compensate for the loss of advertising revenue under an à la carte regime in two possible ways. They can seek to increase the amount that they charge cable operators for the programming, and/or they can reduce their expenditures on the acquisition and production of programming. Either way, subscribers will be adversely affected. Increased fees to cable operators are likely to be passed through to the reduced number of subscribers who choose to purchase the programming. On the other hand, a reduction in programming expenditures will reduce the quality of programming available to consumers.

For some networks, the impact will be more severe. As retail prices increase, fewer customers will opt to purchase a service. It may not be possible to recover lost advertising revenues by raising wholesale prices, because there may not be a sufficient number of customers

[31] *Id.* at 30.

willing to pay a price high enough to cover the programmer's lost revenues. Cutting programming expenditures in lieu of raising wholesale prices may not solve this problem, because reducing program quality will also reduce demand for the network.

Where this occurs, the effect on a program network may be fatal. In these cases, the effect is to reduce the number of networks available to all customers. And, as Booz Allen points out, the most likely networks to disappear are smaller niche networks and independent, non-vertically integrated networks.[32] Launch and development of new networks, which has been a primary spur to increased cable viewership in recent years is likely to slow or come to a standstill.

Cable operators' increased costs associated with à la carte are also likely to be passed through to consumers. As Booz Allen points out, cable operators would set prices for new offerings to cover any incremental costs. Moreover, cable operators have little leeway simply to absorb significant cost increases. Because of their massive investments in system rebuilds and their high ongoing maintenance expenses, operators' interest expense and depreciation average approximately 40% of current average revenues per subscriber. Yet their earnings *before* interest, taxes, depreciation and amortization (EBITDA) are approximately 36% of average revenues per subscriber. In these circumstances, operators would have strong needs to maintain cash flow from video programming as costs increase.

How does this play out for consumers under the three scenarios of pure à la carte, optional à la carte, and a themed tier? The answer varies depending on the extent to which programmers are able to increase their fees to cable operators to compensate for lost advertising revenues or are instead required to reduce their programming expenditures. Booz Allen shows

[32] *Id*. at 37.

that at either extreme – and at all points in between – nearly all consumers would be worse off than they are today. Booz Allen believes that the likeliest result is somewhere near the midpoint of the two extremes, and its estimate of the effects on consumers in each of the scenarios assumes this result. Even those customers who opted not to purchase services on an à la carte or themed tier basis would have to pay substantially more than they pay today *just to continue* receiving the currently existing tiers.

In the pure à la carte scenario, all customers purchase services on an à la carte basis and must become *digital* customers, with digital boxes on all television sets. Under that scenario, if customers purchased only those services that they regularly watch, Booz Allen estimates that the average household's bill would increase by *22%.*[33] To pay no more than they pay today, à la carte customers would have to limit their selection to no more than *six* cable networks.

The optional à la carte scenario yields a similar result: If 50% of cable customers were to opt for à la carte, Booz Allen projects that operators would have to set à la carte prices at a level that would similarly result in those customers paying on average 22% more to receive only those networks that they regularly watch today. This would likely convince most customers not to opt for à la carte. But because of the costs incurred by operators and program networks just to make à la carte *available*, even customers who chose to continue receiving the existing analog tiers would end up paying significantly more than they currently pay.

This is because many of those costs – including increased marketing expenditures by programmers, increased customer care expenditures by operators, and operators' costs of duplicating programming digitally for à la carte customers – do not vary significantly depending

[33] *Id*. at 5.

on how many customers actually opt for à la carte. As a result of these costs, Booz Allen estimates that "consumers would likely bear *at least a 7% increase* in their monthly bill for current tiers *even if no consumers ultimately moved to à la carte* (emphasis added)."[34]

The themed tier scenario fares no better in Booz Allen's model in terms of its effect on the price of cable service. If 50% of cable subscribers were to purchase such a tier in lieu of the entire existing tiers of cable networks, they would also have to pay a price 22% higher than they pay today for those existing tiers. And meanwhile, the costs associated with implementing the themed tier (including increased programming costs) would again cause the price of the existing tiers for *all* other subscribers to increase by at least 7%, even if few or none were to take the tier.

D. Effects on Quality and Diversity of Programming.

Booz Allen concludes that it is likely that program networks would respond, in the aggregate, somewhere between the two polar responses. In other words, they would recapture some of their lost advertising revenues and increased marketing costs by increasing fees to cable operators. But they would also be forced to compensate in part by reducing their own programming expenditures, even as they have to increase their marketing expenses.

To the extent that program networks were required to cut their expenses, the quality of programming would be affected. Such reductions in quality would further diminish viewership and advertising revenues, which, in turn, would threaten the viability of a substantial number of networks. Booz Allen projects a high failure rate, particularly of new and emerging networks, under all à la carte and themed tier scenarios.

Under the pure à la carte scenario, Booz Allen estimates that "at least three-quarters of emerging networks would either fail or be sold to network groups that could capture greater

[34] *Id*. at 8.

scale economies. Moreover, few if any new networks would launch given the potential returns available."[35] Even existing networks would face serious problems. Booz Allen estimates that between one-quarter and one-third of established networks would fail under the pure à la carte scenario.

The results would not be much better under the optional à la carte or themed tier scenarios. Booz Allen estimates that "at least half of emerging networks would fail under Scenarios 2 and 3."[36] And while most established networks would remain viable under those scenarios, "further industry consolidation would likely occur . . . Beyond independently owned networks selling to larger network groups, the major network groups might also seek to merge to improve operating performance."[37]

The overall effect, as stated by Booz Allen, is stark and clear: "[T]he introduction of à la carte or themed tiers would lead to a reduction in the diversity of programming available to consumers, as well as greater concentration of media ownership."[38] When this result is coupled with the projected effect that virtually all customers who opt for à la carte will pay significantly more to receive significantly less – and that even customers who opt to retain their current tiers will have to pay substantially more for the same amount of programming – it is hard to imagine how à la carte would serve the public interest.

III. THE CANADIAN EXPERIENCE DOES NOT SUGGEST THAT À LA CARTE WOULD BENEFIT CONSUMERS IN THE UNITED STATES.

Some proponents of à la carte requirements have suggested that the introduction of limited à la carte options in Canada somehow indicates that à la carte would be a workable

35 *Id*. at 10.

36 *Id.* at 11.

37 *Id*.

approach in the United States. But examination of the actual facts of the Canadian experience makes clear that this is not the case.

The vast majority of Canadian consumers buy their cable programming in analog tiers, the same as most U.S. cable customers.[39] In terms of price, total number of channels, and networks offered, most of those Canadian analog offerings are roughly the equivalent of U.S. expanded basic packages.[40] As in the U.S., many of the most popular cable networks are offered on a tiered basis and include A&E, CNBC, CNN, HGTV, The Family Channel, Discovery Channel, Food Network, Country Music Television and The Golf Channel, as well as Canada's own most popular networks like MuchMusic and TSN-The Sports Network.[41] Some, but not all, operators offer these analog channels in two or three smaller tiers rather than one large tier. This arrangement developed largely due to the fact that the Canadian government sequentially authorized cable carriage of different networks. A few systems in French-speaking Quebec Province offer an all digital service, so some popular English-language networks are part of an à la carte menu. But even in those systems, the operator requires the purchase of a digital tier of service as well as digital receiving equipment – these customers cannot just "pick and pay" for five or six cable services. Moreover, despite claims that U.S. cable channels freely and willingly

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[38] *Id*.

[39] In 2003, only 1,615,154 of Canada's 7,228,843 cable customers purchased digital service. This represents a digital take rate of 22%.

[40] For prices ranging from $43 to $45 (Canadian) subscribers receive 63 to 68 channels of programming. There are no analog boxes on Canadian systems; adding the cost of an analog box to a U.S. cable subscription accounts for somewhat higher expanded basic costs on some systems in the U.S.

[41] It was stated in recent testimony before the Senate Commerce Committee that ESPN was offered à la carte in Canada. *See Senate Commerce Committee Hearing* (statement of Gene Kimmelman, Director, Consumers Union). That statement is incorrect. ESPN is not sold in Canada as it would compete directly with Canadian owned sports channels. ESPN Classic Canada, licensed by The Sports Network, Inc., is a diginet service which is available on digital tiers, theme packages and à la carte.

chose to be offered "à la carte" in Quebec, nothing could be further from the truth. Cable systems in Quebec duplicated carriage of these services on digital without prior consent.[42]

A. Only Digital Cable Customers Have Access to À La Carte in Canada and Several Purchases Are Required Before À La Carte is Available.

À la carte always requires specialized set-top equipment, so Canada's à la carte offerings are only available to digital cable customers. Most Canadian cable operators offer digital tiers, including themed packages of digital programming, and also allow customers to "pick and pay" for individual digital channels from some of the dozens of digital program networks. Under "pick and pay" on many systems, customers can choose one channel for $1.99 - $2.49;[43] five channels for $5.95 - $9.95 and ten channels for $9.95 - $14.95 (all Canadian dollars, prices vary by operator).

However, whether in the special circumstances of French-speaking Quebec or elsewhere, Canadian cable customers must make several other purchases before they can exercise any à la carte options. For example, on many if not most systems, Canadian cable customers must purchase a package of about 30-35 analog channels before they can buy services à la carte. This basic tier is typically comprised of broadcast stations and government and educational channels, and costs about $23 (Canadian) per month. In addition, each TV set requires a digital converter

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[42] A Canadian wireless cable operator (LOOK TV) was the first provider to offer services on an à la carte basis in Montreal in 1998. LOOK TV offered no packages but opted to go all à la carte. At its peak, LOOK TV served approximately 120,000 customers. However, today LOOK TV serves about 20,000 video customers, has abandoned a pure à la carte approach and now offers programming in one large bundle (LOOK PLUS), and the company is in receivership.

[43] Other à la carte purchases involve multicultural channels, with much higher prices ranging from $12 - $25 for Arab, Korean, Chinese and Polish language channels.

to receive à la carte. Cable customers can purchase a digital set-top box for $200+ or lease it for about $9 - $14 per month.

For Quebec systems, the customer's minimum purchase would include a digital basic package, plus a digital tier, plus the digital box, resulting in a monthly fee of about $40 for 54 channels.[44] Only after those purchases can a customer "pick and pay" for a single channel. So, while an à la carte option is available to digital cable customers, there is no evidence that this option has reduced cable bills. A customer wishing to purchase just two à la carte channels would have to spend about $36 - $42 per month. And this customer would not get the most popular analog channels for this price. Thus, it is not surprising that a relatively small percentage of Canadian cable subscribers have availed themselves of this option.

Customers more commonly choose to buy digital theme packages, such as "More Movies" (six movie channels for $7.99) or French language packages (4 to 9 channels for $4.99 - $6.99). Finally, as in the U.S., Canadian cable operators offer analog/digital packages including premium movies and a digital box rental for an all-in-one price.[45]

B. Canada's Limited À La Carte is Significantly Different From Advocates' Proposals for À La Carte in the U.S.

While advocates cite Canada's à la carte option as precedent, it is important to recognize the significant differences between Canada's limited à la carte offerings and proposals to impose an à la carte regime in the U.S.:

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[44] The digital tier on these systems can include channels of the customer's choosing instead of a themed package, but that digital tier requires a minimum of 20 channel selections and costs more than the themed digital packages. For example, Videotron's 18 channel English language tier (i angelo) or 14 channel French language tier (i franco) is $4.99 cheaper than the Pick 20 option. Most of Videotron's digital customers who opt for "choice" take the Pick 30 option. These 30 channels ($41.99 including digital basic) are more expensive than Videotron's most popular 38 channel i telemax tier ($37.99 including digital basic). Again, Quebec cable systems are unique reflecting the lesser demand for English-language services among French-speaking viewers

[45] The "Ultimate Digital Package" as offered by Rogers includes six English-language theme packages but not all 72 of its digital networks as the French-theme package is priced separately.

- Canadian à la carte applies only where the technology supports à la carte, namely for digital cable services. There is no à la carte for analog-only customers.

- À la carte is not generally available for the most popular Canadian cable networks; these services are typically only offered on analog tiers. Moreover, channels can't be removed from analog and placed on digital without permission from the program network. With very limited exceptions, the only place where the most popular English-language networks are offered à la carte is in French-language areas where by definition they have less appeal and where associated advertising revenues are minimal.

- For digital tier customers, themed packages are usually the better buy compared to à la carte; picking more than three or four of these channels on an à la carte basis costs more than the whole theme pack of 6 to 9 channels.

- While digital à la carte in Canada does offer pricing options, digital cable penetration figures do not suggest that it leads to more customers being satisfied. Canada's digital cable penetration stands at 22% while U.S. digital cable penetration stands at 30%. This nearly 50% higher U.S. success rate with this new product may be, in part, the result of Canada's more complicated and confusing digital cable pricing structure and its regulatorily constrained program offerings.

- Where digital à la carte is offered, most consumers take digital packages rather than pick packs or à la carte. The take rate for à la carte is extremely low.

If anything, the Canadian experience actually *supports* the conclusion that the U.S. cable operators have broadly reached: there is significant reason to believe that consumers prefer tiers and scant evidence that consumers want their programming delivered on an à la carte basis.

For these reasons, it is not surprising that when asked, "Why can't subscribers pay just for the channels they want?" the Canadian Radio-television and Telecommunications Commission ("CRTC") responded:

> By offering the programming services in packages, cable companies are able to ensure a wider audience base for each service and reduce individual fees. *If cable customers were to select and receive only the channels they wanted, they might*

have to pay as much, or more, for one channel as they now pay for an entire package of programming.[46]

IV. A REQUIREMENT THAT CABLE OPERATORS OFFER SERVICES ON AN À LA CARTE OR THEMED TIER BASIS WOULD VIOLATE THE FIRST AMENDMENT.

Any law or regulation that compelled cable operators or program networks to package their programming in a particular manner would, on its face, raise serious First Amendment problems. The Supreme Court has repeatedly made clear that cable television "is engaged in 'speech' under the First Amendment, and is, in much of its operation, part of the 'press.'" *Leathers v. Medlock*, 499 U.S. 439, 444 (1991). *See also*, *e.g.*, *Los Angeles v. Preferred Communications, Inc.,* 476 U.S. 488, 494 (1986); *Turner Broadcasting System, Inc. v. FCC*, 512 U.S. 622, 636 (1994).

A law that required a newspaper to make each of its sections available separately, or to permit subscribers to choose not to receive and pay for particular columns or syndicated features that they find offensive, would be unthinkable. The Court has indicated that regulations of the speech activities of cable operators may, in some instances, be subject to less stringent scrutiny than similar restrictions on newspapers. But it has left no doubt that such regulations are subject to heightened First Amendment scrutiny – particularly when they are not regulations of general applicability but apply particularly to cable and other media. *See Turner Broadcasting*, *supra*, at 640-41. Moreover, a regulation that singled out a particular type of programming (such as "family friendly" programming) for preferential packaging and distribution would be subject to the most stringent scrutiny, just as in the case of the print media. *See U.S. v. Playboy Entertainment Group, Inc.*, 529 U.S. 803, 813 (2000).

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46 Canadian Radio-television and Telecommunications Commission, *Frequently Asked Questions* (emphasis added), *at* http://www.crtc.gc.ca/eng/faqs.htm#Q9B (last visited Apr. 8, 2004).

NCTA asked constitutional law experts Geoffrey R. Stone (Harry Kalven Distinguished Professor of Law) and David A. Strauss (Harry N. Wyatt Professor of Law) at the University of Chicago to assess how an à la carte or themed tier requirement would fare under the standards and scrutiny established by the Supreme Court. Their paper, attached to these comments, concludes unequivocally that "both the à la carte requirement and the themed tier requirement would violate the First Amendment."[47]

Professors Stone and Strauss note, first, that there do not appear to be any content-neutral government interests of sufficient importance to justify an à la carte or themed tier requirement under the "heightened scrutiny" standards set forth in *Turner*, much less under the strict scrutiny that would apply to a content-based themed tier requirement. They show that satisfying that desire for more choices is hardly as substantial or important interest as those asserted in justification of the must-carry rules in *Turner*. For example, the must-carry rules were premised on the notion that, absent such rules, "a medium that has become a vital part of the Nation's communication system" would be "endangered."[48] No remotely comparable threat is posed by the absence of à la carte rules.

Furthermore, the importance of promoting the availability of allowing consumers to pick and choose among services that are currently bundled together is undermined by the fact that "[c]onsumers frequently do not have the opportunity to purchase the component parts of . . . goods and services à la carte"[49] – and the government does not generally view such bundling as problematic:

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[47] Geoffrey R. Stone & David A. Strauss, "The First Amendment Implications of Government-Imposed À La Carte and Themed-Tier Requirements on Cable Operators and Program Networks" (2002) ("Stone & Strauss") attached to these comments as Attachment B) at 3.

[48] *Id.* at 5-6.

[49] *Id.* at 11.

> In all of these situations, the nature of the package in which particular goods or services are provided – and whether and to what extent an à la carte option is available – depends on the costs of supply and on the nature of consumer demand. Some consumers may want, but be unable to obtain, particular options that the market does not offer. This is an inherent feature of any well-functioning market economy. If the cost to producers of supplying a product in à la carte form is high, and the demand for the product in that form is insufficient to justify the cost, the product will not be offered à la carte.[50]

This is not to say that bundling is *never* viewed as problematic. But, as Professors Stone and Strauss point out, the federal government has established a way to address tying and bundling arrangements that depart from the norm of competitive, pro-consumer marketplace conduct: "[I]f, in a particular market, the packages offered by sellers reflect anticompetitive conduct, the antitrust laws can address the situation. Well-established principles of antitrust law forbid certain kinds of tying arrangements and monopolies."[51] Similarly, the antitrust laws provide a means for determining whether particular "vertical restraints" imposed by a wholesaler on the manner in which its goods or services may be offered for sale by a retailer are pro-competitive or anticompetitive.

There is no reason to believe that these generally applicable antitrust laws are insufficient to determine whether, in any particular circumstances, the bundling of cable services departs from normal competitive conduct. And, in the absence of *any* successful antitrust challenges to such bundling, it is a quantum leap to conclude that a broad requirement that cable services be unbundled in *all* circumstances is somehow necessary to promote any government interest.

Moreover, the Supreme Court made clear in *Turner* that a regulation that singles out and restricts the protected speech of a medium of communications must be justified by the "special characteristics" of that cable medium. But, as Professors Stone and Strauss point out, "[t]he

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[50] *Id*. at 12.

[51] *Id*. at 13.

proposed à la carte requirement singles out cable operators for a particularly onerous regulatory regime that is not imposed on other providers of news, information, entertainment, and education, or even on other providers of goods and services that are *not* engaged in First Amendment activity, even though the condition that gives rise to the proposal – the absence of an à la carte option – is present throughout the economy."[52] For that reason, such a requirement "would clearly violate the First Amendment."[53]

In any event, to pass First Amendment muster, a restriction on the speech rights of cable operators must not only be justified by a sufficiently important government interest that is based on the "special characteristics of the cable medium." It must also be crafted to advance that interest. As Professors Stone and Strauss point out, however, "there is no assurance that the proposed à la carte requirement would either substantially expand consumer choices *or* lower prices" – its ostensible purposes.[54] To the contrary, as the previously discussed analysis by Booz Allen shows, an à la carte regime would have precisely the opposite results. For most consumers, à la carte and themed tier requirements would result in higher prices to receive the same or fewer service – and fewer networks and less diverse and lower quality programming from which to choose.

The disconnect between the objectives of à la carte regulation and its likely effects would be sufficient to render such regulation unconstitutional if it had *any* significant effect on protected speech. In this case, however, as Professors Stone and Strauss show, the effect on protected speech would be *substantial* – "much greater" than the impact found by the Court in *Turner*.

[52] *Id.* at 13.

[53] *Id.* at 14.

In *Turner*, the Court found "[s]ignificant evidence" that "the vast majority of cable operators have not been affected in a significant manner by must-carry" and "[c]able operators have been able to satisfy their must-carry obligations 87 percent of the time using previously unused channel capacity."[55] By contrast, as Professors Stone and Strauss point out, an à la carte regime would "require a fundamental change in the editorial and business practices of all cable operators." It would "alter, in a very significant way, the relationships of cable operators to networks and customers and interfere with their constitutionally protected editorial discretion."[56]

For these reasons, Professors Stone and Strauss conclude that "a mandated à la carte regime would violate the First Amendment," even under the intermediate "heightened scrutiny" established in *Turner.* A requirement to offer a specific content-based themed tier (as opposed to simply requiring that tiered services be offered à la carte or in smaller "mini-tiers") would face the most stringent First Amendment scrutiny. And it, too, would be unconstitutional.

Professors Stone and Strauss note that such a requirement appears to have two related justifications – helping subscribers avoid *viewing* content that they might find distasteful, and enabling subscribers to avoid *paying* for such content. "Neither justification," they conclude, "is sufficient to sustain the constitutionality of a themed tier regime."[57]

That the first justification fails to pass strict scrutiny "appears to follow a fortiori from the Supreme Court's decision in *United States v. Playboy Entertainment Group*, *supra.*"[58] In that case, the Court stated that "[w]here the designed benefit of a content-based speech restriction is to shield the sensibilities of listeners, the general rule is that the right of expression prevails,

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54 *Id*. at 8.

55 *Turner Broadcasting System, Inc. v. FCC,* 520 U.S. 180, 214 (1997)("Turner II").

56 Stone & Strauss at 15.

57 *Id*. at 17.

even where no less restrictive alternative exists."[59] There may conceivably be exceptions to this rule where there is a compelling interest in protecting viewing of specific content (particularly by children). But in the present case – as was the case in *Playboy* – there *is* a less restrictive, content-neutral alternative. Cable operators can – and are required to – provide, blocking mechanisms to prevent unwanted access to *any* programming on a tier purchased by a subscriber. And, as the Court held, "if a less restrictive means is available to the Government to achieve its goals, the Government must use it."[60]

The second justification, according to Professors Stone and Strauss, is wholly at odds with the purposes of the First Amendment. Forcing cable operators to assemble and offer packages that exclude content that is deemed objectionable "would constitute a content-based invasion by the government into the very heart of the editorial process."[61] Professors Stone and Strauss doubt that any government-imposed themed tier regulation of speech could *ever* be justified, but, "[C]ertainly, such a government action cannot be justified on the ground that some consumers wish to subscribe to some channels without paying for others that they find objectionable."[62]

CONCLUSION

The Booz Allen analysis not only confirms GAO's conclusion that many cable customers would be made worse off under an artificially induced à la carte regime. It shows that, under each of three variations of à la carte and themed tier approaches, virtually *all* cable customers would be worse off. Customers would have to pay considerably more to receive fewer services

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58 *Id*.

59 *Playboy Entertainment Group*, 529 U.S. at 813.

60 *Id.* at 815.

61 Stone & Straus at 19.

(or, in the case of optional à la carte or themed tiers, more even if they opted to receive the same tiers that they do today). And the number of networks and the quality and diversity of programming available for viewing would, in all cases, be significantly diminished.

To have any chance of paying less than they pay today for the entire array of networks available on basic and enhanced basic tiers, à la carte cable customers would have to purchase considerably fewer networks than even the relatively small number that they watch heavily and regularly, much less those that they view occasionally. If they were instead to opt to continue purchasing the entire tier (if such an option is available), the price of that tier would be significantly higher because of the costs associated with making à la carte or themed tiers available.

This is a trade-off that, as a matter of public policy and consumer welfare, makes no sense. A competitive marketplace would never produce such an outcome. That marketplace is likely to continue expanding the array of programming options and choices for consumers – including options available on a per-channel, mini-tier, or per-program basis. But it will not do so in a way that makes consumers pay less for more and diminishes the quality and value of available programming, as government-mandated restructuring would do.

Respectfully submitted,

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[62] *Id*. at 20.

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